United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

76-7305

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 76-7305

JAMES ARNEIL, VERNON A. STOCKWELL

Plaintiffs-Appellants

- against -

JAMES B. RAMSEY, JR., OLIVER DeG. VANDERBILT, WILLIAM M. LENDMAN, BLAIR & CO., INC., THE NEW YORK STOCK EXCHANGE,

Defendants-Appellees.

On Appeal from the United States District Court
Southern District of New York

REPLY BRIEF FOR PLAINTIFFS-APPELLANTS

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Jeffrey A. Fillman
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Introductory Statement

A cursory reading of the Brief for Defendant-Appellee, New York Stock Exchange, Inc., and a comparison of that Brief with the Brief of Defendant-Appellees Ramsey, Vanderbilt and Lendman, establishes that the Exchange is not merely defending the decision of the Court below granting the Exchange's Motion for Summary Judgment with respect to Counts I through IV, XII and XIII, as to which plaintiffs have appealed, but is also effectively attempting to cross-appeal from Judge Brieant's denial of the Exchange's Motion for Summary Judgment with respect to Counts V, VII, VIII and XI. In so doing, the Exchange is attempting to have this Court reverse on issues that the Exchange

expressly did not press in the Court below. Directing Judge Brieant's attention to Judge Lasker's decision in Lank v. New York Stock Exchange, 405 F.Supp. 1031 (S.D.N.Y. 1975), to Judge Gurfein's decision in Weinberger v. New York Stock Exchange, 335 F.Supp. 139 (S.D.N.Y. 1971) and to Judge Bonsal's conclusion in Weinberger that the six-year statute of limitations applicable to contract actions should govern claims for breach of the Exchange's agreement with the SEC under Section 6 of the Securities Exchange Act of 1934 (the "1934 Act"), counsel for the Exchange stated to Judge Brieant that "we do not press the limitations argument under Section 6." (See Transcript of Hearing annexed hereto at pp. 3-4.) The significance of that representation to the Court is not destroyed by the fact that, in an obvious attempt to preserve for argument on appeal a contention that he was not pressing in the Court below, counsel for the Exchange later stated that he did not "waive the point." The very failure of counsel for the Exchange to press in the Court below any contention concerning the three-year statute of limitations with respect to contract claims under Section 6 suggest the weakness of that contention: in any event, it precludes the Exchange from now seeking reversal of the Court below on a ground that was not pressed in that Court.

Argument

I

The Court below correctly found that the six-year contract statute of limitations governs the plaintiffs' claims for breach of the Exchange's Section 6 Agreement.

The Exchange's Brief concedes that its contentions with respect to application of the six-year contract statute to claims under Section 6 is completely contrary to virtually all authority on that point. The Exchange recognizes that Weinberg v. New York Stock Exchange, supra, is squarely in point and supports plaintiffs. The Exchange also recognizes that Judge Lasker's decision in Lank v. New York Stock Exchange, supra, and in Fischer v. New York Stock Exchange, 408 F.Supp. 745 (S.D.N.Y. 1976), as well as Judge Williams' decision in Carr v. New York Stock Exchange, 414 F.Supp. 1292 (N.D. Cal. 1976), and Judge Pierce's decision in Verace v. New York Stock Exchange, 76 Civ. 613 (S.D.N.Y. Sept. 22, 1976), also contradict the position the Exchange would have this Court take.

Wilson v. Meyerson, Civ. No. 72-1293 (N.D. Cal. April 1976), the only case cited by the Exchange as supporting its contention, in fact never considered the question whether a cause of action for breach of the Exchange's Section 6 agreement with the SEC is governed by the statute of limitations applicable to contract actions or the statute applicable to actions for breach of a statutory duty. In Wilson the Court was faced only with a choice between the statute of limitations

applicable to claims for breach of a statutory duty and the statute applicable to tort claims for fraud: the applicability of a statute of limitations governing causes of action for breach of contract was not in issue.

Given the total absence of judicial authority for its contention that a claim for breach of its Section 6 agreement is governed by the statute of limitations applicable to claims for breach of a statutory duty, the Exchange would have this Court believe that, except for Weinberger, the decisions supporting the plaintiffs' position never really considered the issue. Since the Courts in Carr, Fischer and Lank presumably had the "benefit" of substantial breifs and argument by counsel for the Exchange to the effect that Weinberger should not be followed, it is hardly likely that the Courts did not fully consider the merits of the issue.

The Exchange suggests that, because the "duties" assumed by the Exchange under its agreement with the SEC are "virtually co-terminous" with "duties" already imposed by the 1934 Act, the agreement should be disregarded as a source of obligations upon which a beneficiary of the agreement might assert claims and that the statute and not the agreement is the only basis for any such claims. Even assuming that the decisions in Weinberger, Lank, Fischer and Carr did not exist to refute the Exchange's position, the reasoning offered by the Exchange in support of its contention is plainly fallacious. The logical (but absurd) extension of the Exchange's contention is that a

party to a contract may only sue in tort where negligent behavior has caused damage even if the contract contained an express covenant by the negligent party to use due care. According to the Exchange, no action would lie for breach of the contractual covenant because the obligation created thereby would be "virtually co-terminous" with an obligation to use due care which already exists under common law. The simple answer to the Exchange's contention is that it has long been established that a party may agree contractual obligations which may be co-terminous with existing obligations otherwise imposed by law: thus contracts may create for the parties thereto a "second string" to already existing "bows" in the event the obligations are breached.

Inasmuch as this issue is at the heart of the concurrent appeal by the Exchange in Lank (No. 76-7243), the appellants in Arneil respectfully refer the Court to the thorough briefing of the issue by the Plaintiff-Appellee in Lank.

II

Plaintiffs had standing to assert their claims for breach of the Section 6 agreement: In any event, the standing question raises material issues of fact which cannot be resolved upon summary judgment.

In arguing that plaintiffs' claims based upon the Exchange's agreement under Section 6 should have been dismissed the Exchange is again pursuing in this Court a contention that

it did not press in the Court below. A review of the Transcript of the Hearing on the Motion for Summary Judgment (annexed hereto) demonstrates that the standing argument is but a last-minute makeweight.

Indeed, in making the argument the Exchange is flatly taking issue with Judge Brieant's express finding that "Here plaintiffs were public customers of Blair who later became subordinated lenders and shareholders in the firm." That finding was essential to the Judge Brieant's conclusion (in favor of the Exchange) that no fiduciary duty was owed to plaintiffs since they were only "public customers" and Baird v. Franklin, 141 F.2d 238 (2nd Cir. 1944), had held the Exchange not to have fiduciary obligations to public customers of member firms.

The Exchange cannot have it both ways: If the plaintiffs were "public customers" for purposes of their fiduciary duty claims, they necessarily must also have been "public customers" with respect to claims based on the Section 6 agreement between the Exchange and the SEC. In any event, the breach of duty to plaintiffs took place at a time when their status as public customers cannot be disputed by anybody's standards: The breach of duty took place at that point in time when Blair & Co. was inducing plaintiffs to alter their status from undisputed "public customers" of Blair to the arguably ambiguous status of owners of stock and SDL accounts with respect to Blair. Insofar as the breach of duty arose in connection with that apparent transformation in status, the breach was to "public

customers" whom the Exchange concedes have standing to sue under Section 6.

Moreover, the question whether plaintiffs were "public customers" of Blair after they became owners of SDL accounts, if material to a disposition of the case,cannot be disposed of on summary judgment because it would raise questions of fact concerning the nature and degree of involvement of plaintiffs in the internal affairs and management of Blair which cannot be decided on summary judgment.

In any event, the Exchange's argument with respect to plaintiffs' standing is also inconsistent with well-established and well-reasoned precedent. That precedent is not limited to New York Stock Exchange v. Sloan, 394 F.Supp. 1303 (S.D.N.Y. 1975), which the Exchange mentions in passing (Exchange Br. at p. 25). In Collins v. PBW Stock Exchange Inc., 408 F.Supp. 1344 (E.D.Pa. 1976), the Court reviewed all relevant precedent and justifiably concluded that the standing question must be decided with reference to the objective of the 1934 Act to promote protection of the investing public. Thus, the question depends not on an unreasoned characterization of the plaintiffs as"public customers" or investors in a member firm, but on a determination whether they were responsible in any way for the wrongful acts of the member firm. Since there is no claim that plaintiffs participated in the affairs of Blair, they would be entitled to the protection of the Act and would have the required standing. See also Pettit v. American Stock Exchange, 217 F.Supp. 21 (S.D.N.Y. 1963).

III

The Section 10(b) claims should be governed by the six-year New York statute of limitations.

A. The Federal Insurance case is not distinguishable in a meaningful way.

The Exchange and the individual defendants argue that the Section 10(b) claims are barred by the Washington three-year statute of limitations because they "arose without the state" of New York. In attempting to demonstrate that the causes of action "arose" in Washington, the appellees attempt to distinguish Federal Insurance Co. v. Fries, 355 N.Y.S.2d 741 (Civ. Ct. N.Y. Co. 1974), on the ground that the issue there involved a determination of the choice of substantive law, not a procedural question. Such a distinction is fallacious. Although federal substantive law governs the determination of obligations and rights as between the parties with respect to claims under Section 10(b), there is no question but that the governing statute of limitations is that which would be applied by a New York State Court. The Federal Insurance Co. case (as well as the Exchange's articulation of its own argument) clearly demonstrates that a New York Court would have to first determine where the cause of action arose before it might determine whether the Washington statute of limitations should be applied under the New York borrowing statute. Indeed, that was the very issue before the Court below and is the very issue in this case, namely, whether the cause of action -- the claim against the defendants for their breaches of duty -- came into being in New York or in Washington. As the Exchange

recognizes and as Judge Brieant recognized in the Court below, in order to determine where the cause of action came into being it is essential to determine the nature of the claim and the point in time when it came into being. Since the federal court must ascertain which statute of limitations a New York State Court would apply to the analagous fraud action (a Section 10(b) action not being cognisable in a state court) the Court below was required to determine how a New York State Court would go about determining where and when the fraud cause of action arose in the present case. In this respect the question is virtually identical to that raised in Federal Insurance. There it was essential to anlayze the nature of the cause of action in order to determine when the cause of action arose for statute of limitations purposes: Here it is necessary to determine where the cause of action arose for statute of limitations purposes. However, since the appellees contend that a cause of action arises in the state where the damages were sustained it is essential to their argument to determine when the cause of action arose as well as where it arose. Accordingly, the approach taken in Federal Insurance is equally applicable to the present case and the distinction offered by the Exchange is without significance.

Although both appellees' Briefs suggest that plaintiffs would have this Court ignore or reverse Sack v. Low, 478 F.2d 360 (2d Cir. 1974), it should be apparent from appellants' main Brief that they are not so contending. The point simply stated is that

Sack v. Low held (a) that the Federal Court should follow the approach a New York State Court would take and (b) that circumstances such as open accounts or their equivalent might dictate application of the New York statute of limitations since the Court below failed to consider the relevant authorities indicative of the approach a New York Court would take and failed to consider the relevance of the actual facts surrounding plaintiffs' SDL accounts, it was the Court below, not plaintiffs who disregarded the teachings of Sack v. Low.

B. New York had most meaningful contacts with the transactions and conduct giving rise to plaintiffs' claims.

The substantial contacts which the plaintiffs and the relevant transactions had with New York have already been outlined in their main Brief on Appeal. Although the Briefs of the appellees focus on alleged contacts with the State of Washington, the New York contacts are not disputed. Moreover, the appellees ignore the fact that the SDL notes which are central to plaintiffs' claims provided for payment to Blair in New York and the Collateral Agreements defining the relative rights of plaintiffs and Blair expressly provided that all aspects thereof, including matters of validity and performance, were to be governed by New York Law. (See Appendix 2 hereto.) Plainly, at the time of the transactions which resulted in plaintiffs' injuries and claims, all concerned (including the appellants) intended New York law to control any and all disputes as to any and all issues.

It is, therefore, disingenuous for appellees to now urge that the accident of plaintiffs' residences justifies complete frustration of the original concept that the relevant transactions should be treated for all legal purposes as New York transactions.

The suggestion by the Exchange (Brief p. 40) that plaintiffs could have brought this action in Washington is patently unsupportable. Since none of the acts or omissions of the Exchange or the individual defendants which gave rise to plaintiffs' claims were done in Washington and neither the Exchange nor the individual defendants are present and transacted their relevant business in Washington, this action could not have been brought in the Washington federal Court (and certainly could not have been brought in a Washington State Court).

IV

The fact that plaintiffs may have been aware of Blair's fraud as early as 1970 is not evidence that plaintiffs were aware of the Exchange's involvement with Blair's fraud at that early date.

The Exchange defends Judge Brieant's conclusion that the statute of limitations began running in September 1970 (when plaintiffs had an awareness of possible claims against Blair) on the apparent premise that an awareness of possible claims against Blair ipso facto meant an awareness of possible claims against the Exchange. However, there is no evidence whatsoever in the record to support that proposition. Accordingly, the Exchange would support the proposition by characterizing plaintiffs' claims as premised solely upon the Exchange's approval of plaintiffs' applications to become investors and SDL account

holders with respect to Blair. However, a review of applicable law and the entire record should make it abundantly clear that plaintiffs' claims against the Exchange must be and are based on the fact that in connection with its approval of plaintiffs' applications, the Exchange was subject to certain obligations to plaintiffs and, given the state of the Exchange's knowledge at the time, that duty was breached. In the Carr case (supra) the Court noted that the Exchange's liability must be premised on the fact that it "knew or had reasonable cause to know of a violation or suspected violation of a securities law, regulation or rule, or Exchange rule, and failed to proceed with requisite due care in view of the seriousness of the violation, pertinent SEC policies, the rules and practices of the Exchange, and the interests of the member firms, their security holders and the public customers of the Exchange" (414 F.Supp. at 1299). The same standard at very best would apply to the individual defendants.

The fact that plaintiffs may have become aware of Blair's misrepresentations does not mean that they became aware of facts indicating breach by the Exchange or by the individual defendants of the flexible standard to which they were subject. The fact that plaintiffs knew the Exchange had to approve their application was certainly not knowledge that the Exchange was aware of all of the problems and difficulties in Blair and of the probability that Blair's activities in obtaining investments and SDL accounts from plaintiffs involved violation of the 1934

Act. That knowledge -- that the Exchange was doing nothing to insure that plaintiffs had the same knowledge about Blair that the Exchange did -- did not come to plaintiffs until long after Blair had become defunct and their investment had been lost. In any event, there is certainly not a shred of evidence in the record indicating that plaintiffs became aware of the palpable state of mind of the Exchange more than three years prior to commencement of this action. At the very least the defendants' contentions on this matter raised genuine issues of fact.

Thus, Judge Brieant's unreasoned conclusion that the statute began running as to the claims against the Exchange and the individual defendants in 1970 was reversable error.

CONCLUSION

The decision of the Court below summarly dismissing Counts I through IV, XII and XIII should be reversed and the case should be remended for trial.

Dated: October 19, 1976
New York, New York

Respectfully submitted,

FINLEY, KUMBLE, WAGNER, HEINE & UNDERBERG

Attorneys for Plaintiffs-Appellants
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425 Park Avenue
New York, New York 10022

Of Counsel:

Jeffrey A. Fillman
J. Thomas Hannan

APPENDIX 1

because of the running of the statute of limitations on each of those claims.

Insofar as the statute of limitations defense to the Section 6 claims -- and this is part of the reason we --

THE COURT: Does this motion end the case as to your client?

MR. REILLY: Does this motion indicate --

THE COURT: Does this motion end the litigation as to your client?

MR. REILLY: Yes, your Honor, if granted it would.

THE COURT: In other words, all the counts in which your client is named would be disposed of?

MR. REILLY: That's correct.

THE COURT: You may continue.

MR. REILLY: In the plea memorandum which we have submitted, there is annexed an opinion by Judge Lasker which was rendered on December 29th. Judge Lasker had concluded, as previously did Judge Gurfein and I believe Judge Bonsal in the Weinberger decision, that the six-year statute should govern under Section 6, and that it applies more specifically to claims under Section 6A.

In light of that decision, we do not press the

limitations argument under Section 6. We do not waive the point.

THE COURT: I don't understand your point. What are you saying?

MR. REILLY: We argue it in our motion that the Section 6 claims should be stricken by reason of the statute of limitations and that there is no Section 6A claim for failure of the Exchange to enforce its own rule.

THE COURT: So you now say that the Section 6 claims are not barred by limitations?

MR. REILLY: I believe they are, your Honor, but I realize that there are decisions such as Judge Lasker's which we have presented to the Court, which come at it differently. I don't know whether the Court of Appeals would agree or not, but I would like a decision where we don't have to go up to the Court of Appeals and then come back and try the case.

THE COURT: Well, you will have to go up anyway. Whether you come back and try it is a different question.

MR. REILLY: I would feel more confident if the Court did not find it necessary to reach the limitations issue on Section 6 and that the Court could resolve the Section 6 claims as a matter of law, apart from the statute

APPENDIX 2

SECURED NOTE

Date: 4/15/69

$150,000.00

FOR VALUE RECEIVED, I promise to pay to BLAIR & CO., INC. (the "Corporation") at its principal office at 20 Broad Street, New York, New York (where presentment and demand for payment shall be made), without interest, the sum of ONE HUNDRED FIFTY THOUSAND AND NO/100 Dollars ($150,000.00), on demand.

This Note is secured at its date by the pledge of the securities and cash, if any, described in Schedule A annexed hereto.

This Note and the securities and cash from time to time pledged to secure it are subject in all respects to the provisions of a Collateral Agreement of even date between the Corporation and the undersigned, a copy of which may be examined at the principal office of the Corporation.

The Corporation, by acceptance hereof, agrees, for itself, its representatives, successors and assigns (1) that neither I, my heirs, executors, administrators or assigns shall be personally liable on this Note, it being intended that my obligation to pay the principal amount of this Note is included for the sole purpose of establishing the existence of the indebtedness represented hereby, (2) that in the event of default the Corporation and any such successor or assign shall look for payment solely to the security of the property then pledged to secure the same, and will not make claim or institute any action or proceeding against me, my heirs, executors, administrators or assigns for the payment of this Note or for any deficiency remaining after application of the property pledged to secure this Note, or otherwise; provided, however, that nothing herein contained shall be construed to release or impair the indebtedness evidenced by this Note, or of the lien upon the property pledged to secure it, or preclude the application of said pledged property to the payment hereof in accordance with the provisions of Paragraph X(b) of the Collateral Agreement.

s/ Vernon A. Stockwell
Payor

N.Y.S.E. - STOCKWELL
Ex. #34

ANNEX A

TO SECURED NOTE

CASH: NONE

SECURITIES:

AMOUNT	SECURITY
4600 shares	City Investing Co.
1000 shares	Servotronics

New York, N. Y.

Date: April 15, 1969

Blair & Co., Inc.
20 Broad Street
New York, N. Y. 10005

COLLATERAL AGREEMENT

Dear Sirs:

I. General. The undersigned has executed in favor of you, Blair & Co., Inc. (the "Corporation"), a Secured Note of even date in the form of A-nex 1 hereto. As used herein, the term "Note" shall mean such Secured Note, as such note may be modified from time to time and any note substituted therefor in accordance with the terms hereof; and the term "Indebtedness" shall mean the unpaid principal amount of the Note.

II. The Collateral. As security for the payment of the Indebtedness, the undersigned hereby pledges to the Corporation the securities and cash, if any, described in Schedule A annexed to the Note, as such Schedule A may from time to time be amended in accordance with the terms hereof. As used herein, the term "Securities" shall mean the securities so described in Annex A, and the term "Collateral" shall mean the securities and any cash or other property at any time pledged hereunder.

III. Ownership and Property Rights with Respect to the Collateral. The undersigned shall have the following rights and obligations with respect to the Collateral, subject in all respects to the rights of the Corporation as the pledgee of the Collateral, as set forth herein and in the Note (including Paragraph XI (b) and (c) hereof, and prior to any liquidation as therein provided):

(a) General. The undersigned shall have and retain full legal and beneficial ownership of the Collateral and shall have the benefit of any increases and bear the risk of any decreases in the value of the Collateral. The undersigned shall have the sole right to vote or consent with respect to the Securities; shall have the sole right to any income therefrom or distribution thereon by payment of interest or dividends or otherwise; subject, however, to the right of the Corporation to receive and hold as pledgee all dividends payable in Securities and all partial and complete liquidating dividends; and shall pay all taxes or other charges assessable by any governmental or taxing authority against him, upon or with respect to such Securities or the income therefrom or distributions thereon or the gain or loss of value thereof.

(b) Purchases and Sales of Collateral. The undersigned shall have the right at any time and from time to time to direct the sale of any of the Securities, and to direct the purchase of securities with any cash included in the Collateral; provided, however, that the net proceeds of any such sale and the securities so purchased shall be received and retained by the Corporation as Collateral for the Note; and provided further, that no such transaction shall be permitted without the consent of the Corporation if the effect thereof will be to reduce the capital requirements value (as hereinafter defined) of the Collateral. The undersigned shall have the right to pledge additional cash or securities as Collateral. As used herein, the term "capital requirements value" shall mean the net value of property for the purposes of computing Net Capital under Rule 325 of the New York Stock Exchange (as that Rule is now in effect or as amended from time to time).

(c) Withdrawal or Substitution of Collateral. The undersigned shall have the right at any time and from time to time to withdraw the whole or any part of the Collateral; provided that he substitutes at the same time as such withdrawal, cash or securities or both having a capital requirements value at least equal to the capital requirements value of the Collateral so withdrawn.

* * * * *

V. Withdrawal of Note. (a) Subject to the conditions herein provided, the undersigned shall have the right at any time prior to a demand by the Corporation for payment of the Note to withdraw the Note and the Collateral. Such withdrawal shall be effective at the expiration of six months after the end of the month in which written notice thereof is given to the Corporation by the undersigned, or at such earlier date as the Corporation may specify in writing.

* * * * *

X. Notice to Exchanges and Subordination. (a) No return reduction or withdrawal shall be made under Paragraph V or VI hereof until after written notice thereof has been given to the New York Stock Exchange, the American Stock Exchange or any similar institution with which the Corporation has qualified for privileges the maintenance of which requires such notice.

* * * * *

(e) Governing Law. The Agreement shall be deemed to have been made under, and sha-l be governed by, the laws of the State of New York in all respects, including matters of construction, validity and performance.

* * * * *

Kindly indicate your acceptance of the foregoing by signing the two copies hereof in the space indicated and returning one to the undersigned, thereby constituting the foregoing an agreement among ourselves.

s/ James Arneil

Address 605 Doneen Bldg.

Wenatchee, Wash.

98801

ACCEPTED AND CONFIRMED

BLAIR & CO., INC.

By_____